DOW THEORY LETTERS INC.

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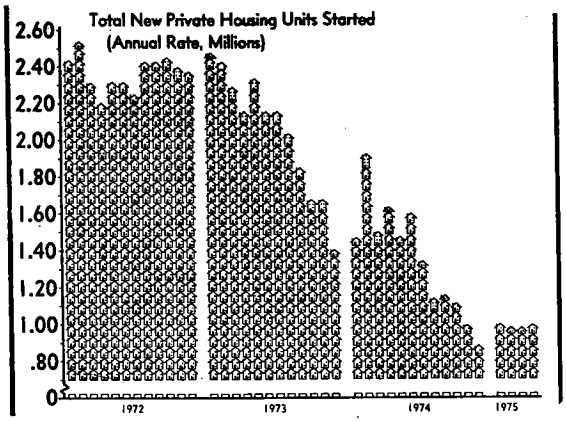
BULLS, BEARS, ECONOMY, ELLIOTT: Question: Russell, what do you see for the market over the intermediate term? Answer: Well, I am a firm believer in the thesis that the market will do what it has to — to fool or upset the greatest number of people (Iguess you could call that "contrary opinion" in action). It strikes me that a real fooler here would be a forthcoming decline by the market with the Dow wiping out perhaps half or more of its 1975 gains.

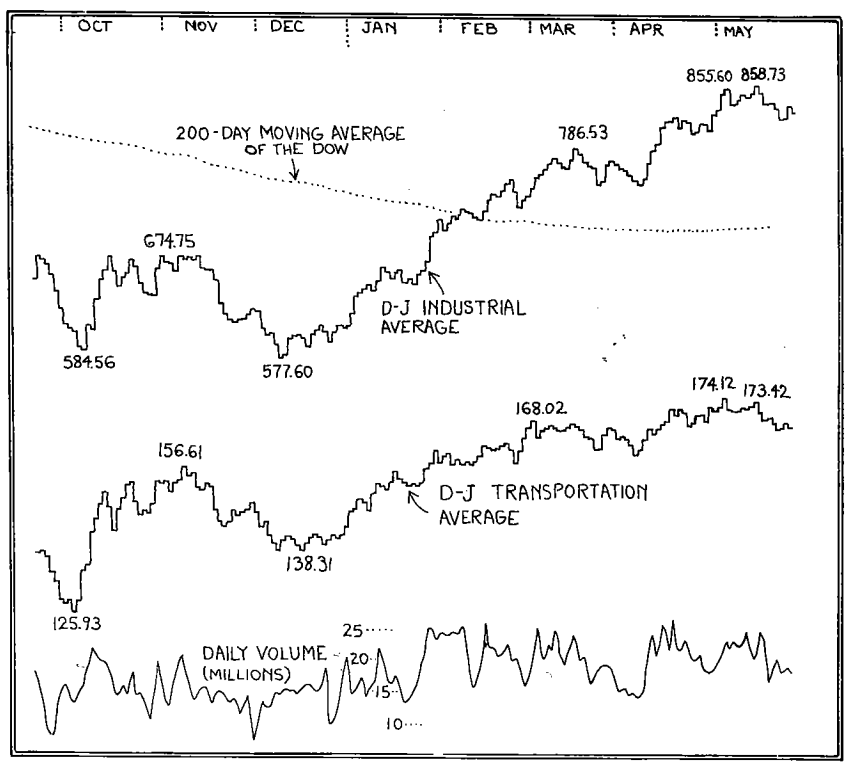
Question: C'mon, Russell, why would that be such a big surprise? Answer: Because I think that the majority now expects the Dow to continue to push to new highs, maybe even to all-time highs before 1975 is out. On the other hand, a very vocal minority believes we are still in a primary bear market. They believe that the economy will continue to sink until full depression conditions are reached, and they also believe that new lows will be seen in the market. In view of all this, I feel that a major correction but no new lows on the Dow would serve as the biggest fooler. Such a correction could result in a great deal of fear selling, a change of heart among many leading analysts, and general consternation all around.

Question: What about the economy under such conditions? Answer: This question requires a rather lengthy answer, but here goes. Understandably, everyone is anxious to see the economy turn up in a convincing way. And, of course, everyone is eager to publish, announce or broadcast any kind of optimistic news or statistic. For instance, it was widely announced that housing starts were up in April (up over March), but glance at the accompanying chart (courtesy of M/G Financial Weekly). The April starts are still very low, below an annual rate of one million per year. They are barely above the March rate, and far below the comparable April rate a year ago. Thus a housing turnaround is still just a hope, despite the optimistic announcement.

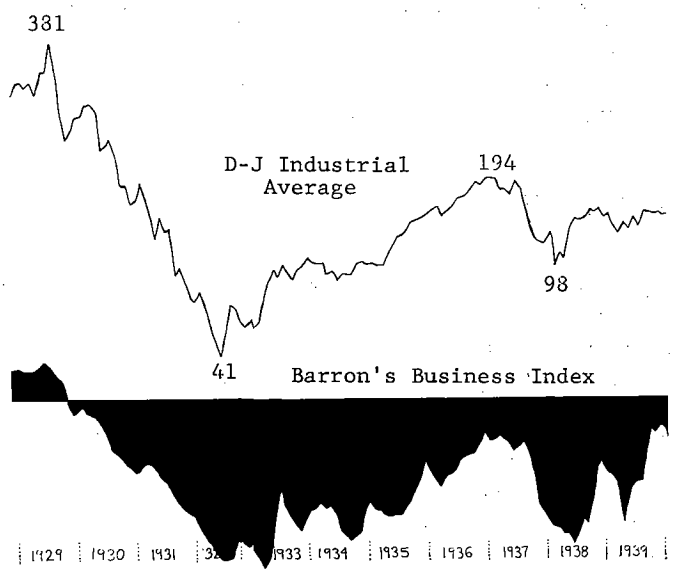
Last week I went back to my studies of two previous crash aftermaths, those of post-1932 and post-1937. The action of Barron's Business Index during those periods was most interesting, and I include a section of my chart on page 2. Note that the Dow hit its low, following the 1929-32 collapse, in July, 1932 at 41.22. Barron's Business Index hit a low a few months later. Business then rose until the end of the year (while the Dow doubled). But business turned down again, sagging to a new low in the first quarter of 1933. So we see that the final business bottom came eight months after the actual market low. What happened next? Business continued sluggish, and as seen on the chart the Business Index moved up during mid-1933, then generally drooped into 1934. Finally, for a period of two years (1935 and 1936) business seemed to expand quite briskly. But the recovery was fated to be rather short-lived.

The year 1937 was marked by a severe stock market crash. The crash was accompanied by an equally severe business collapse. The market bottomed in April, 1938 with the Dow at 98.95. Barron's Business Index hit bottom in June, 1938, two months after the Dow low. Business expanded vigorously during the remainder of 1938, then plunged during the first half of 1939. During the rest of '39 the economy expanded steadily as the war clouds of World War





Il grew darker, and as the defense industry began to stir itself in earnest.

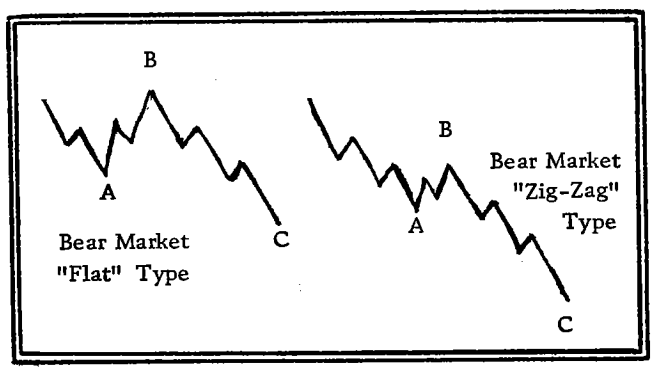


The point, however, is that following both of these severe crashes, there was no immediate, sustained pick-up in business, and I have wondered if the same general kind of picture (i.e., a jerky sporadic recovery) might not be in the offing now. After all, a market crash is a very rare phenomenon. And the aftermath of a crash is usually no picnic.

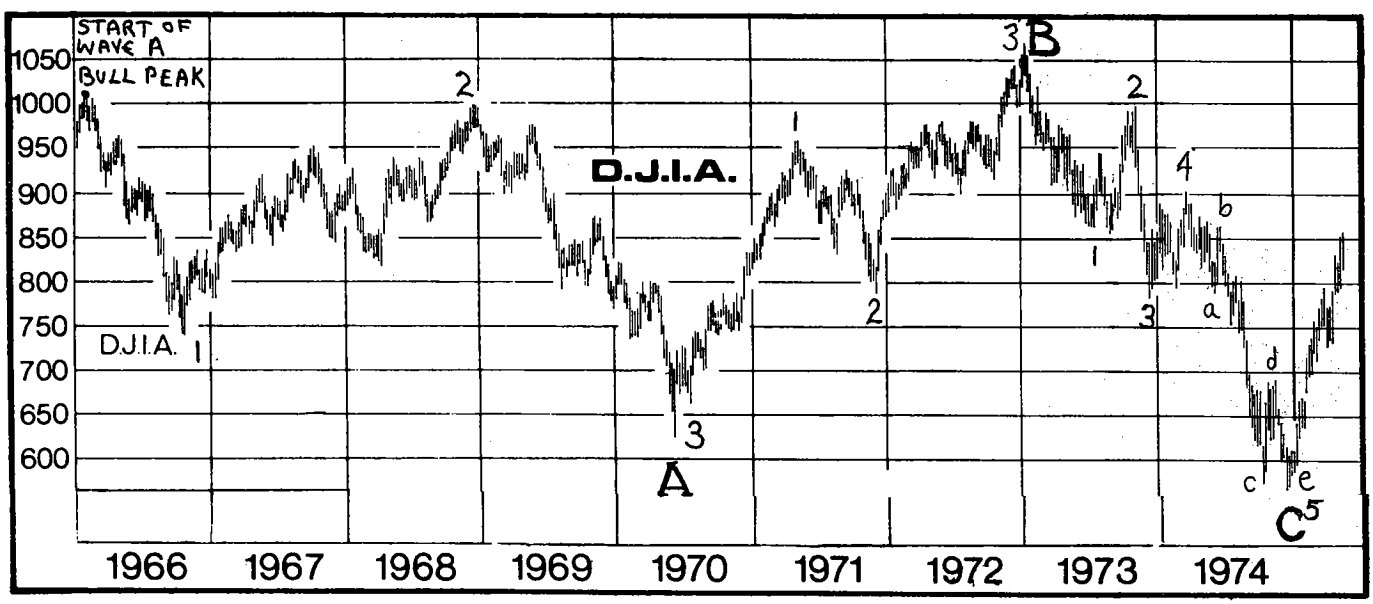
Question: You have been saying that from the standpoint of your Elliott Wave studies you are of the opinion that the bear market is over. Would you update your Elliott studies in the light of that statement? Answer: I used Elliott in my bullish Special Report of December 20, 1974. I went into Elliott in some detail in Letter 613, Oct. 30, 1974, and I do not have the space to present a full Elliott Wave discussion here. However, I do want to include this chart of the Dow (weekly) covering the years 1966 to the present. I have labeled the chart with figures and letters according to my own Elliott interpretations. (Chart courtesy of Stock Market Alert, England).

As discussed in previous Letters, I felt that the 1966-74 bear market was assuming the broad form of an A-B-C Elliott "flat." A flat correction differs from the more severe "zig-zag" correction in that the flat A-B-C often contains an A-B second leg in which point B carries above the previous bull market top. Following B, a relatively shallow C leg should take the bear market to new lows. Note on the chart that in actuality, point B took the Dow to 1051.70, which was well above the 995.15 of 1966. Following the B leg, the Dow plunged to new lows of 577.60 at C, but point C (577.60) was not too far below the termination of the A leg at 631.16 for the Dow.

Flat corrections take the form of three major A-B-C legs with sub-divisions of the three legs usually running as follows: 3 intermediate waves in leg A, 3 in leg B and 5 in leg C. This is known as the 3-3-5 flat correction. Note that I have labeled the chart to show well-defined 3-part divisions in waves A and in wave B. Wave C is more complex with 4 intermediate waves (labeled 1 through 4) and then a 5 wave that breaks up into 5 smaller waves labeled a through e. Note that minor wave e, intermediate wave 5 and major wave C all ended in December, 1974.



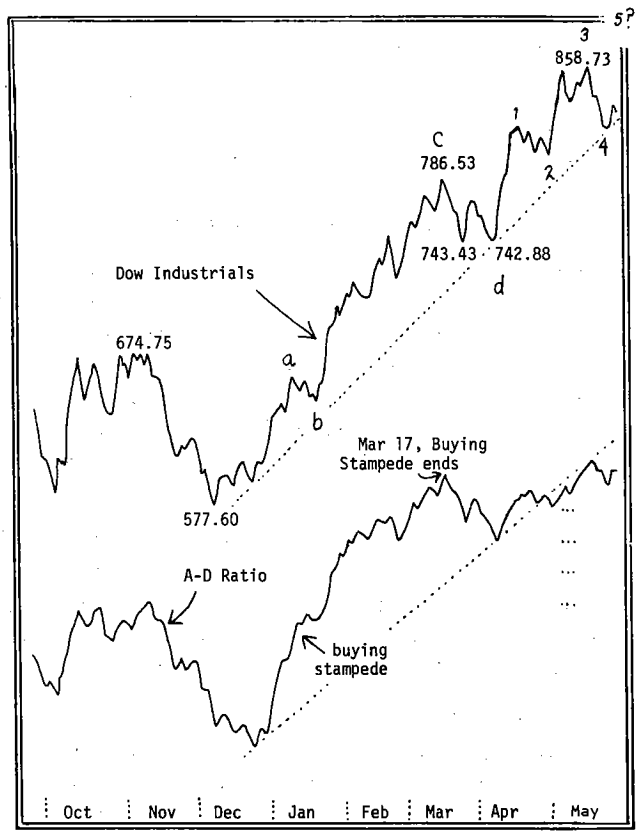
Question: How do you classify the current rise from the December low, according to Elliott? Answer: I classify it as wave A of a new bull market. As I count it, we have completed an a-b-c-d of a 5-leg major A advance. The e leg has extended so that we could have one more new high on the Dow (above the 858.73 of May 13) before the current rise ends and a full-scale correction sets in. I



have illustrated this by labeling my Elliott count on the Dow (as seen in the accompanying chart of the Dow and the A-D ratio on this page).

Question: In view of the so-called mild flat correction in the Dow, how is it that so many individual stocks lost 70% to 90% of their value in the bear market? Answer: Most non-Dow stocks or I should say most lesser quality stocks underwent much more severe corrections of the zig-zag bear market variety (rather than flats). This phenomenon was illustrated in the December 20, 1974 Special Report. It is also true that the unweighted stock market averages suffered zig-zag type bear market corrections, with many of these averages losing 70% to 80% of their values during 1973-74. In contrast, the Dow lost 45% of its value during 1974-74.

MARKET — NEAR-TERM: From the standpoint of Dow Theory, we still have the problem of the upside non-confirmation by the Transportation Average on May 14 (see page 1 chart). On May 14 the Industrials rallied to a new 1975 high (closing) of 858.73 but Transports failed to better their preceding May 5 peak of 174.12. Following that seemingly minor failure, both Averages sold off with Industrials halting their downside move on May 21 at 818.65. Transports held at 166.42. An April 23 rally (occurring on the last trading day prior to the Memorial Day holiday) bounced Industrials up almost 13 points, but Transports continued sluggish.



The first definitive downside indication from here would be a break by both Averages below their May 21 lows, Industrials below 818.65 and Transports below the very nearby 166.42 level. If such a joint break brought in volume, it would certainly imply a deteriorating price structure. In that case, the 800 level for the Dow would be the next downside target.

I will say again that a primary bull market is entitled to every benefit of the doubt, and so far this market (throughout 1975) has laboriously worked its way out of every technical test, tests that included a major A-D ratio non-confirmation, a lagging Transport Average, a poor Utility showing since February, and a high-low index that topped out at 393 daily new highs on March 17, 1975.

Despite all this, I will classify the secondary trend of the market as bullish as long as the Dow holds above 800. If the Industrials break 818.65, then 800 on increasing volume, the odds would suggest that a full secondary reaction is in the making.

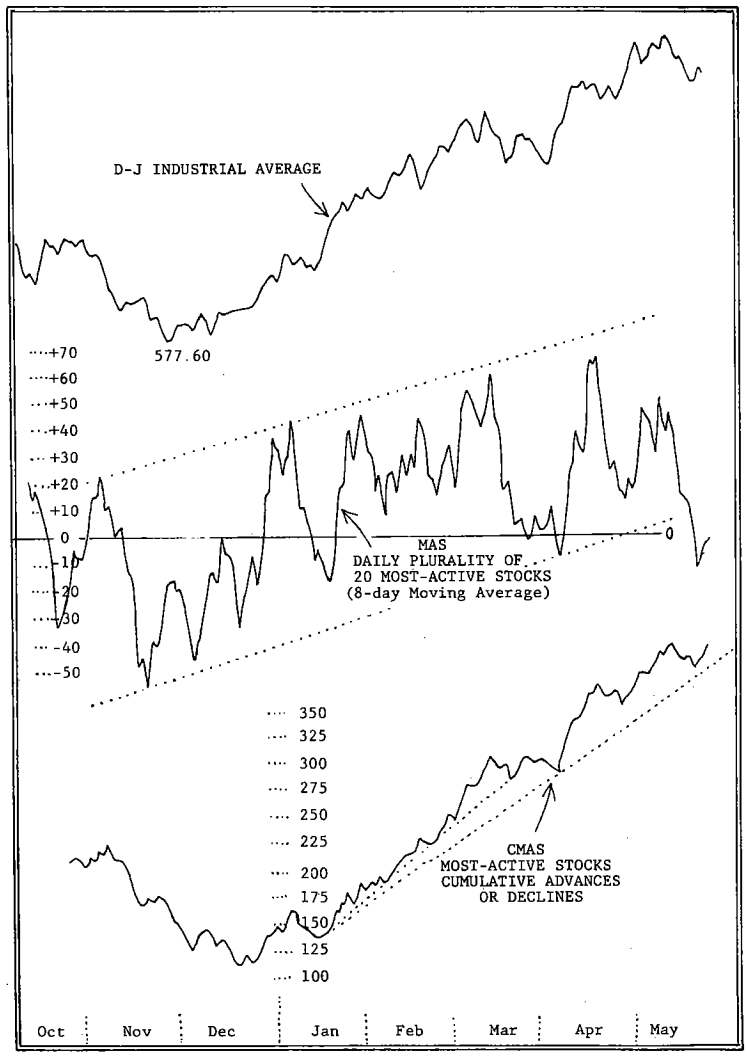
In the last report I called attention to the "wedge pattern" in the Industrial Average. This pattern (as so often happens with a wedge) has now taken on the potential for a "head-and-shoulders" top (see page 1 chart). Assuming that the action since May 23 represented the "right shoulder," it would still require a breaking of 800 by the Dow to complete such a top.

As seen on the chart, the May 9 confirmation by the A-D ratio (above its March 17 peak) brought in no real resumption of market strength. In fact, as this is written, the market as measured by the A-D ratio is still about where it was on March 17, despite the fact that the Dow is currently approximately 50 points above its March 17 high. How this is all fated to work out still remains a mystery, hidden in the great unconscious of Wall Street. My own appraisal is (as it has been since mid-March) that the market is tired but cannot yet be counted out. I would say further that without better action on the part of the Utility and Transport Averages than we have seen in April, this market is going to have a tough time making further upside progress from here (without first undergoing a correction).

MOST-ACTIVE STOCKS: The strongest single technical area of this market has been the most-active stocks. Each day the NYSE releases a list of the 15 most active stocks for the day. I compute the daily plurality of stocks which advanced (or declined), and I use these pluralities to construct two indices. I do this on the theory that big money (either speculative, investment or both) tends to concentrate its activities in the most active shares. On any given day, the most active volume may constitute 15% to as much as 30% of total Exchange volume. I have also found that the direction of the most-active stocks tends to point the way for the rest of the market.

The first index used is a simple 8-day moving average of the daily most-active pluralities. This index is referred to on the chart as MAS (see chart page 4). This is an oscillating index, running as (bullishly) high as plus 70 and as (bearishly) low as minus 70. The second index is an advance-decline index of the plurality, and this index shows the build-up or the break-down of the daily figures on a cumulative basis. I refer to this daily cumulative most-active index as CMAS.

The chart shows an extraordinary rising channel formed by a steadily rising trend in MAS from October to May. Note that since December, 1974 there were only two temporary drops below the zero line and into negative territory (negative territory is below zero). These negative dips occurred during a few days in January and again for a few days during April.



On May 21 MAS dropped below zero for the third time in 1975. The latest below-zero plunge also took MAS out of its 7 - month rising channel on the downside. It is still too early to tell, but I feel that the most actives could slowly be working into a distribution phase with a declining channel now in the process of formation.

On the bottom of the chart we see the CMAS line. Note that CMAS remained above a rather steep trendline all during December to March. In late-March the steep rising trendline gave way to a shallower trendline, and this trendline has held intact for six months or from December to the present.

I present the most-active study at this time, because it is often true that the strongest technical indicator is the one that bears the closest watching as a major bull movement unfolds. One by one, the weaker technical indicators may reverse to the downside, but when the strongest goes (and in this bull market the strongest has certainly been the most-active stocks indices), we generally have a reliable signal of a turn to the downside.

So far, studying the most-active indices, we can say that MAS has broken decisively out of its eight-month rising channel, but CMAS is still intact. We will have the first joint bearish reading on the most-active indices if CMAS now breaks below its rising trendline as seen on the chart.

THE CENTER: There is a tendency for everything in nature to gravitate towards the "center" or the center of balance. Some psychologists term this process homeostasis, a movement by the organism towards equilibrium. The organism has many needs, and each need upsets its homeostasis until that need is satisfied. Once satisfied, a degree of homeostasis is again reached. All of life, in all areas, is seen as an interplay of balances and imbalances. When these balances are badly out of kilter, the organism becomes sick. When the process of homeostasis ends (or when the organism give up on its homeostasis activities) it dies.

I am writing about this process because I think an understanding of it will aid my readers both in their investment stance and even more important, in their understanding of life. The "coming into balance" process appears in every culture and every religion. In Zen it is called centering, in hippie terminology is it termed "getting it together," psychologists call it integrating. The process is referred to or implied by Christ repeatedly. For instance, in this passage from the Bible, Jesus tells his listeners (and this is my interpretation) to stop "freaking out" on big meals, extensive wardrobes, quantities of liquor and the pursuit of money. You'll get what you need, he says, so put the main part of your efforts into "getting your head on straight":

"Therefore I say unto you, take no thought of your life, what ye shall eat, or what you shall drink; nor yet for your body, what ye shall put on. Is not life more than meat, and the body more than raiment? Behold the fowls of the air; for they sow not, neither do they reap, nor gather into barns; yet your heavenly Father feedeth them. Are ye not much better than they?" (Matt. 6:25).

I have found that it is a great help in centering to remember that things are seldom as good as the optimists think they are or as bad as the pessimists say they are. A concentration on one or theother pole usually means that the person has a vested interest in the rosy view or the black view. Few if any of us can see absolute reality. We can't see it because our vision is blurred by our prejudices, our ignorance, our fears and our wishes. The real effort is in getting through our own murkiness and into the searing clarity of inner and outer reality.

I recently saw a film dealing with the life of the great psychiatrist Carl Jung. Jung spent his entire life working on getting the various parts of himself together. The night before he died he had a dream in which a voice told him that he at last had succeeded. The voice told him in stentorian tones, "Well done, Dr. Jung." With that the ultimate meaning of his life struggle was realized. My own theory is that we live as long as we are on the path towards integration, effectiveness, reality.

Those who are on that path help themselves and help others. Those who are not on that path are alive only because they may yet get on the path or because they may serve as examples to those who are moving.

The greatest single aid to integration is the dream. I have spent 25 years working on my own dreams in an attempt to derive at the reality of myself. I have delved into most of the techniques for interpreting dreams, and I don't think any school has the answer. But the concept that has meant by far the most to me is the Gestalt approach which states that the dream is a device by which the person attempts to integrate his own personality. Each item, person, object, of the dream, is a symbolic part of the self, and the dream is an attempt to put many of these "missing parts" together. Thus two men fighting in a dream may represent two parts of yourself that are struggling in an attempt to reach balance or integration. One part (the stronger man) may be the "should" part, the part of you that is always saying you should do this or that. The other fighter (the weaker but perhaps more sly and more primitive man) may be the "want" part of you, the part that says, "Yeah, I know I should do that, but I want to play cards instead, so take it easy, I'll do it tomorrow." When the two fighters shake and get together, your should's and want's will get together. It is said that the man who has truly integrated his want's and his should's is at the very least a genius.

"OK," you say, "You've bent my ear long enough, Russell. What's this all got to do with me and the market?" My answer is that the man who is trying to see the reality of himself (and thus the world) is the one who is most likely to see the reality of the market, and thus do best in the market. You have probably seen the Oriental Yin-Yang symbol that represents man's two halves. The one half (Yin) is the shadowed right half, and it is emotional, receptive, feminine. The light half (Yang) is aggressive, masculine, creative. But note (small dots) that each half has a trace of the other in it. The integration of the two halves from the circular Yin-Yang symbol, the complete man. This symbol implies the continuing struggle of the light and the dark, yet when integrated the symbol is round, completed.

The stock market follows the same kind of structure, and it follows the same process. The bull and the bear, the optimism and the pessimism, the primary move and the correction, the boom and the depression, always moving towards equilibrium, always following its cycles, yet always in flux.

In concluding this piece I want to add that it has helped me to think of the market as an extension of life just as you and I are an extension of life (if you are religious you obviously realize that I am substituting the word life for God). Thus, just as you are attempting to reach homeostasis, balance, so is the market. If the market goes up too far, it is going to come back towards equilibrium. If interest rates go down too far, they will rise towards equilibrium. If General Motors declines too far, it will rally.

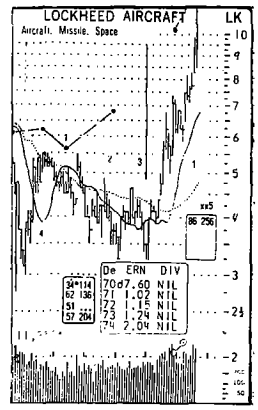
Great fortunes have been made by those who could see extreme movements as movements which will ultimately correct, move back towards equilibrium. And this is the reason I have been writing about the great yields now available in many fixed income vehicles such as bonds, notes, preferred stocks, etc. The world has leaned too far in favor of spending, deficits, loans, and the barometers of these imbalances are very high (and attractive) interest rates. Yet, there will be an ultimate return towards equilibrium. At that point we will see more liquidity, lower interest rates, perhaps harder times, and the Yin-Yang circle of economics will once more move toward completion.

STOCK COMMENTS: I've spent the weekend going through the NYSE list of preferred and convertible preferred issues. Frankly, the Utility issues give me a start; they make me wonder. Issue after issue of Utility preferred's provide yields of 10%, 11% and more! As you know, preferred stocks are ownership or equity shares, usually do not have voting rights, but do receive dividends ahead of the common. Thus the preferred's are not bonds in that they do not represent company debt, but they do pay dividends before any common dividends. Either today's 10% to 12% yielding Utility preferred's are the biggest bargains around — or there's something drastically wrong with the whole picture.

I'm not going into all the fundamentals such as the sky-rocketing costs to the Utilities of new facilities or the rising cost of bringing in new money. But I do say that something strange is happening in the psyche of the investment world. I talked with my friend Jim Dines last week, and he keeps coming back to what he terms "the coming anti-capitalism." I couldn't agree more, only I have termed it "confiscation of capital." What is happening is that the nation and its politicians are developing an attitude that can be described as "The hell with investors, speculators and stockholders." The investors puts his capital into a Minicipal bond or a Utility bond and the bond runs into trouble. So the politicians say, "We've got to serve the public, and if the bondholders get shafted, the devil with them. After all, they knew what they were doing when they bought 'em. Our job is serving the people, not the speculators." And that's the attitude that's growing fast, very fast. And it's 100% anti-capitalism, it's irresponsible and it's ominous.

Result: With people who know, nothing is safe enough today, and that's why the much-squeezed Utility industry is seeing its preferred's (which were once of super-investment status) now yielding over 9-12% literally across the board. And my recommendation is that you go partly for the top quality yields, which means US Treasury obligations (notes, bills) and you go partly for speculation and appreciation, which means stocks, but the in-between is becoming a very difficult proposition.

I recommended United Technologies and Lockheed in Letter 630. Evidently, some subscribers bought UTX and a great many purchased LK. Suddenly, LK is up over 65% from where I recommended it, and I'm getting calls from subscribers who are wondering what to do. With LK almost 100% above its 200-day moving average (see Chart, courtesy of Quote, PO Box 213, Wichita KS 67201) I would say take profits on half your shares and ride the rest with a mental stop loss at around 10. Thus, you'll have a fast, fat percentage profit on the half you sell, and you'll breathe easier while sitting with the rest. If LK continues to rise, you'll have a speculative picnic, and if LK drops you'll be out around 10 which means a profit on the second half as well. For the investor who wants capital gains, I can only report again that I don't make the market, I only struggle with it. And a short-term gain is a lot better than a short-term loss (or don't you believe that?).



I am not going to recommend any regular stock purchases in this report as I feel that the odds favor a more advantageous period for purchase somewhere ahead. I will say that a few stocks stand out in terms of relative strength at this time, and these include Woolworth, McGraw Hill, Lockheed, General Dynamics, McDonnell Douglas (and, in fact, the Aerospace group in general).

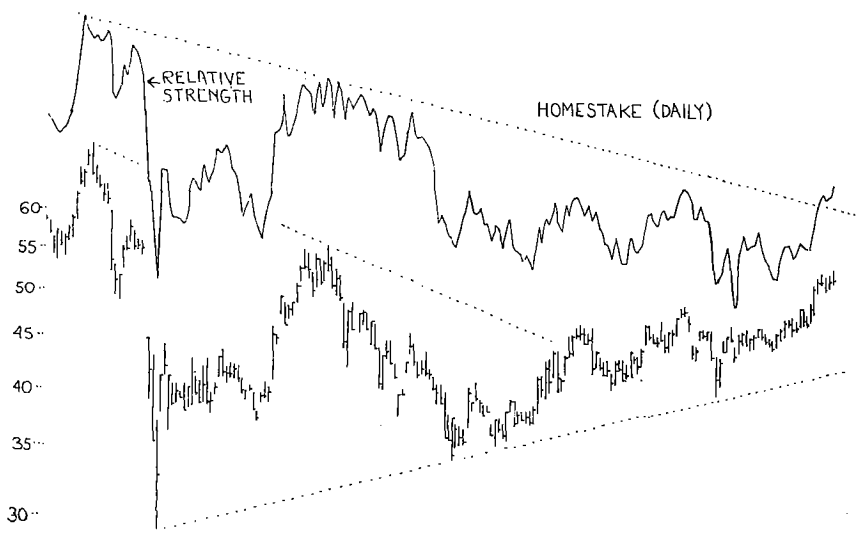
GOLD: We are entering the period in which I stated that gold momentum would be due to turn up. My point & figure chart shows a gold bullion reversal to the upside with gold working up under the rising trendline (a trendline which was broken a few months ago).

Problems: Canada is going very socialistic, rumor has it that Canadian miners are talking about a $1.20 an hour boost on top of the $1.10 boost of last year. This would be well upwards of $2.00 per hour wage costs increase for the Canadian gold mines on top of the higher taxes, and that is a very tough nut to contend with. The fact is that it is going to take a substantial and continuing rise in the price of bullion in order for the mines to increase profits from here. A mild increase in bullion prices would mean that the mines could just about hold their own, as far as earnings are concerned. So much for Canadian problems.

In S. Africa, two small opposition parties are merging to speed the pace for political change, and they want to give all races a full share in governing the country. This means ultimate black-white wage equality in my book. I firmly believe that wage equality is a coming fact for S. Africa (and it may come faster than people think). Already, many mines have felt the squeeze of higher costs, and in many cases dividends for '75 are going to be disappointing. Thus, the S. African mines are not the great gold hedge they were five or ten years ago — unless you envision a massive rise in the price of bullion over the next year or so (and frankly, I don't see such a rise any time soon).

All of which leaves me with the same two suggestions (and I hate to be repetitive) which I have been presenting in the last two reports. Only this time I will say that this represents a definite recommendation. Here it is: I would suggest that subscribers put 15% of assets in two places .....Krugerrands and Homestake Mines. The Krugerrands can be purchased at but slight premium over gold content (each Krugerrand contains 1 ounce of gold). Buy the coins from a reputable dealer or your broker or bank, put them in your bank vault, and forget them.

As for Homestake (HM), I include my daily chart of the US's only important gold producer, and here we see that for the first time, relative strength in HM is outperforming the Dow. For whatever reasons, I feel that HM is now being accumulated. At 53, HM has bettered its two preceding peaks, and it now has the problem of the 55½ peak of last November. No matter, you can buy it as a hedge against future dollar weakness (or gold strength, if you like), and since HM is acting better than either the Canadian or S. African gold shares, informed money must believe that the US is a safer place for a mining entity than either Canada or S. Africa (I come to this brilliant conclusion because I realize that HM is hardly a better gold mine than say Campbell Red Lake or Vaal Reefs; it just happens to be located in a more desirable place).



In buying gold items, however, it is well to avoid kidding yourself. Gold is not booming today, despite all kinds of international altercations, despite threatened new hikes in the oil price, despite an impending pound devaluation. I say hold 15% gold as a hedge against the threat of all-out inflation in the US, and that is the only thing I feel would move gold above $200.

Next issue to be mailed: June 11, 1975.